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31 May 2007

The Office of Gas and Electricity Markets
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FAO: Steve Smith, Managing Director, Markets

Dear Sir

British Gas Trading Limited's ("BGT") response to 'Modifying the Arrangements for the use of Objections in the Non-Domestic Market' consultation

This letter is BGT's response to the consultation dated 17 April 2007 concerning the non-domestic market.

Ofgem's consultation paper of August 2005 stated:

> "With regard to an old supplier's use of the objection raising period to renegotiate a contract, Ofgem considers that it is the responsibility of the customer to determine whether or not a contract offered to them is worth signing. Consequently, it is currently Ofgem's view that restricting a customer's choice and ability to sign a contract with whomever it chooses is inappropriate".

In short, BGT considers that remains the correct view. Ofgem has a crucial role in facilitating a market structure that provides customers with this choice and the opportunity to get a better deal.

BGT accordingly considers that the real issue raised by the consultation is what arrangements in respect of re-contracting in the Objection Raising Period (**"ORP"**) best serve customers' interests.

In this submission, for consistency, we adopt the same terms for re-contracting as were used in BGT's appeal to Ofgem heard on 23 January 2007 appeal (the **"appeal"**). Accordingly, we describe re-contracting which occurs during the ORP as "in contract saves".

This consultation seeks views on a number of points. We respond to each in Appendix 1. In summary, BGT's practice should be allowed to continue because:

1. It promotes competition:

   (a) it offers a customer a choice it would not otherwise have had;

   (b) the offer is made at a critical point in the customer's contract life cycle;

   (c) the industry process during the ORP makes this a trouble free approach for the customer. However, the process could be improved if there were restrictions on suppliers' ability to impose economic disincentives (e.g. early termination charges) on customers who return to their Old Supplier during the ORP;

   (d) it focuses competing suppliers' minds on price and services for the customer's benefit, rather than deterring customer choice through contractual terms such as

early termination costs if the customer decides to accept a more favourable offer during the ORP.

Indeed, it would have an adverse effect on competition if the practice were not allowed because the only supplier excluded from dealing with the customer during the ORP would be the Old Supplier.

2. The pro-competitive effects are not offset by any anti-competitive effects.

BGT anticipates that its competitors will argue that the practice of in contract saves harms new entrants due to the wasted costs if their customers return to the Old Supplier. In our view, this argument is fallacious for a number of reasons.

First, these costs are *de minimis*. The only material cost which could be incurred is in relation to hedging. However, in reality no prudent supplier hedges all his contracts immediately on signature on a customer by customer basis because of customer leakage between contract signature and supply start date, which arises for a multiplicity of reasons. A prudent hedging policy takes such issues into account and, in any event, subsequent customer wins enable suppliers to mitigate any losses as part of an overall hedging strategy.

Secondly, as stated in our submission dated 23 January 2007 at the appeal, over 80 per cent. of customers approached choose not to remain with BGT. Hence, any argument that the practice of in contract saves will have a long term effect on switching is wrong.

Thirdly, there is no evidence that new entrants are deterred from the market. In the last month alone there have been three new applications for supply licences by new entrants in the non-domestic Market.

3. There are two areas where Ofgem can improve the customer's ability to benefit from BGT's pro-competitive practice.

First, it can provide that the New Supplier's contract does not come into binding effect until the ORP expires. Whilst in our view the legal analysis does not support any argument that in contract saves amount to tortious inducement of breach of contract (as to which see below), adopting this suggestion would put the debate beyond reach entirely, to the overall benefit of customers.

Secondly, it can prevent suppliers seeking to levy early termination fees against customers who use the ORP to return to the Old Supplier or a supplier other than the New Supplier whose registration request has triggered the D0058. On the assumption that Ofgem would adopt our first proposal above, in our view, no such fees should be permitted to be levied until a binding contract has come into effect.

These steps will ensure customer choice during the ORP is not in practice rendered illusory by contractual penalties or allegations of tort.

4. Pursuant to section 43 of the Electricity Act 1989, Ofgem is concerned with whether BGT's practice restricts or distorts competition. In connection with the generation, transmission or supply of electricity, section 43 confers on Ofgem the functions of the Office of Fair Trading set out under Part 4 of the Enterprise Act 2002. Section 134(5) and 134(8) of the Enterprise Act 2002 provide that relevant considerations include whether the market feature under scrutiny results in higher or lower prices, higher or lower quality or more or less choice or innovation of goods and services for customers and future customers. BGT's practice offers customers more choice and the prospect of lower prices. A finding in favour of BGT's practice of in contract saves is consistent with Ofgem's statutory duties.

5. Suppliers' concern about in-contract saves is driven by commercial self-interest, not customers' best interests. No customer has complained to BGT about its practice. BGT

believes, in particular, other suppliers' opposition arises because of the inconvenience they would suffer in changing their systems and operations to follow BGT's practices. Preventing customers from receiving lower priced offers will tend to maintain customer status quo, reduce customer leakage and maintain supplier margins, to the detriment of customer choice. Supplier convenience should not be allowed to prevail over customer benefit.

In summary, it would be wrong to endorse any proposal that results in the industry rules being changed to restrict customer choice during the ORP. Re-contracting in the ORP enables customers to consider an offer that, if re-contracting is prohibited, they would not otherwise receive. It is a matter for customers to evaluate such offers and exercise their choice as they see fit. There should be no industry barriers which prevent a customer taking up a better offer. Whether outside the ORP individual suppliers wish to impose contractual restrictions on customers' ability to transfer (to the extent permitted at law), and whether those suppliers actually enforce such restrictions, is a matter for suppliers themselves.

BGT anticipates that its competitors will again allege that its conduct constitutes inducement of breach of contract. BGT has already filed detailed submissions on the economic torts, from which it is clear that the allegations are without merit. Since BGTL's submission, the House of Lords has handed down judgment in **OBG Ltd and others v Allan and others; Douglas and others v Hello! Ltd and others; and Mainstream Properties Ltd v Young and others [2007] UKHL 21** (copy enclosed). It is now beyond doubt that BGTL's conduct does not, on any interpretation, constitute inducement of breach of contract. The knowledge and intention requirements are not met. We enclose a note on inducement of breach of contract prepared by Ashurst in light of the House of Lords' decision.

In any event, only the Courts have jurisdiction to determine whether the tort of inducement of breach has been committed and no proceedings have been threatened or commenced against BGT.

Please do not hesitate to contact me if you require any further clarification on the points made in this response.

Yours sincerely

Ceri Hughes
Head of Industry

Appendix 1 – BGT Response to Ofgem's consultation questions

1. **ARRANGEMENT ONE – AMEND MARKET RULES SO THAT CUSTOMERS ARE UNABLE TO RE-CONTRACT IN THE OBJECTION WINDOW, EXCEPT IN VERY SPECIFIC CIRCUMSTANCES.**

1.1 We do not believe that the market rules should be so amended. It is inappropriate that limitations are imposed so that customers cannot be provided with better offers during the ORP. The only beneficiary of such an amendment is the supplier who has notified a customer win. Customers and other market participants lose out.

1.2 We actively encourage other suppliers to participate in this process; this is a dynamic commercial competitive market. Any restriction on re-contracting during the ORP is wrong in principle and should be rejected. A general ban, subject to limited exceptions, e.g. customer initiated requests, is of no practical significance. It will prove impossible to police and cause confusion and uncertainty for both customers and suppliers. The real alternative facing Ofgem is between the continuation of re-contracting during the ORP or the imposition of a total ban.

1.3 There is no principled basis for excluding the Old Supplier from the ORP. This is detrimental to customers because it reduces competition between suppliers and customers are denied, at the very least, one more choice and, in some cases, a better price. All other suppliers may compete for the customer during this period and all suppliers (including BGT) may approach the customer after the ORP.

1.4 In theory, BGT should receive notice from its customers before receiving the DOO58. The reality is often it does not. If it did, the Old Supplier would find out about the intending transfer, and make a better offer without relying on the D0058 or the ORP ever arising but this is not a viable option. If, rather than using the D0058, suppliers are compelled to hold customers to their notice provisions the transfer process will last considerably longer creating confusion and causing market inefficiency.

1.5 This begs the question: what is the purpose of the ORP if an Old Supplier with a valid objection cannot re-contract with an outgoing customer? If, for example, a customer transfers without giving its Old Supplier contractual notice and the Old Supplier objects, there is no point in the ORP if it simply delays the application for registration for the duration of the notice period without allowing the Old Supplier to use the notice period for its intended purpose.

2. **ARRANGEMENT TWO – ANY RESTRICTIONS ON RE-CONTRACTING ARE NOT AN ESSENTIAL PART OF THE TRANSFER PROCESS AND THAT SUPPLIERS AND CUSTOMERS SHOULD BE FREE TO MAKE AND ACCEPT ALTERNATIVE OFFERS AT ANY TIME.**

2.1 Customers should be free to accept a better offer during the ORP. This approach is consistent with what was outlined in the MRA Case Study of 19 July 2005.

2.2 In contract saves are effective because they come into immediate effect. By contrast, re-contracting with a customer after the ORP is unlikely to be practicable for a considerable period, to the likely detriment of the customer. A very significant proportion of new contracts in the non-domestic market are for durations of one year or longer. Hence, after the ORP, the customer is likely to be locked into a higher priced contract than would otherwise have been available to him.

2.3 BGT submits that suppliers and customers should be free to make and accept alternative offers at any time **during the ORP**. However, at other times, suppliers and customers should only be free to make and accept alternative offers in accordance with the terms of the relevant supply agreement and the law. The ORP provides a window during which an Old Supplier with a valid objection may re-contract with a departing customer. However, it is in the interests of customers and suppliers to ensure that the window does not continue indefinitely with customers transferring between multiple suppliers. Otherwise the continued uncertainty will be detrimental to the efficient operation of the market. In any event, the MRA prescribes a finite timeframe for the ORP, which should be observed.

Once the Old Supplier has re-contracted with the customer, and the objection has thereby been resolved, the ORP is closed.

2.4 BGT's suggested changes to the MRA to deal with the points in 2.3 are set out in 3 of our letter. In short, it invites Ofgem to make the following refinements:

(a) Notwithstanding any words to the contrary in the contract, no supply contract becomes binding until after the ORP has closed.

(b) Suppliers shall not levy termination charges, or any other economic disincentive to transfer, against customers who during the ORP elect to return to their Old Supplier or indeed any other supplier.

3. WHETHER BOTH SETS OF ARRANGEMENTS ARE CONSISTENT WITH COMPETITION.

3.1 Re-contracting during or after the ORP are both examples of competitive activity. The former is less disruptive to the customer, and less administratively cumbersome in terms of numbers of re-registrations. The former is also more immediate and hence more efficient.

3.2 Competition is about enabling a market in which customers are empowered to exercise their will to change supplier at any time. It is not intended to restrict choice at any point. The process that we have adopted does not secure 100 per cent. of the customers approached; in fact it results in less than 20 per cent. of customers choosing to remain with us. This is a clear indication that the customer is in control as Ofgem wished in its consultation of August 2005; they do and should make the decision as to which supplier they wish to use.

3.3 Re-contracting, which would be permissible during the ORP under arrangement two as we suggest it should apply, maximises customer choice and promotes competition. Under this scenario, a customer is given a further, better offer, and the choice whether or not to accept such an offer remains with it rather that any supplier. The current industry rules do not hinder competition. BGT believes the changes it refers to in paragraph 3 of its letter and paragraph 2.4 above will improve competitive market efficiency and certainty.

3.4 Arrangement one would restrict competition for the reasons explained in BGT's letter and in paragraph 1 above.

3.5 We note that suppliers continue to join the market therefore any suggestion that in contract saves restrict competition is unfounded. In fact three new suppliers have applied for non-domestic supply licences in the last month.

4. VIEWS ON WHETHER TRANSACTION COSTS AND CUSTOMER INCONVENIENCE WOULD BE GREATER UNDER EITHER SET OF ARRANGEMENTS.

Transaction costs

4.1 Any supplier can win other customers, provided its prices and services are competitive and Ofgem acknowledges this in their consultation.

4.2 It has been suggested that fledgling suppliers will never to be able to get established in the market due to the transactional costs that are built into their pricing models. A prudent supplier should assume that a customer could transfer not later than the eleventh day following registration and accordingly build this into their transactional costs. Suppliers should have in place robust contracts but must make sure that these are properly explained to the customer at the point of sale (a process which we reinforce by both the consolidation process and a further cancellation period)[1].

[1] For each oral sale, we contact our customer within a matter of days to confirm that they have understood their terms and additionally we offer a cancellation period which allows customers to change their minds for a period of time. Both approaches deliver a transparent and fair practice that we and customers benefit from.

4.3 We condemn the practice of early termination fees applicable during the ORP period for two reasons. First, we have examples where penal rates are being applied and secondly they are being used as a 'quick win' measure for the suppliers concerned, notwithstanding that they have not commenced supply and, consequently, it is very difficult to see how such charges could be a genuine pre-estimate of loss. Such charges operate as a compelling economic disincentive to customers transferring and are therefore anti-competitive. They ought not to be applied in circumstances where the contract in which they are contained is the subject of a valid objection by the Old Supplier which results in the customer re-contracting with the Old Supplier during the ORP.

4.4 As stated above, less than 20 per cent. of customers approached by BGT during the ORP choose to stay. This is not sufficient to deter new entry and the statistics of new entry confirm this: see para 3.5 above.

4.5 It is a commercial matter for suppliers to determine their own strategies and suggesting that re-contracting introduces greater transaction costs does not stand up to scrutiny on either process or economic grounds. Re-contracting during the ORP should involve lower transaction costs than re-contracting immediately afterwards because there is no re-registration required and no minimum period billing sent to the customer.

Customer inconvenience

4.6 Under arrangement one, preventing a customer taking up a better offer during the ORP will result in customer inconvenience at the least and potentially loss of more favourable contract terms as they will have to transfer to the new supplier and then may need to remain with that new supplier for the contract duration, which in the case of business customers is likely to be a minimum of 12 months[2].

4.7 Under the second arrangement, an in-contract save not only offers the customer a last 'contract price check' before they embark onto a fixed contract, but it also means that for those that choose to stay with their existing supplier, they can do so, very simply.

5. WHETHER THE EXISTING MARKET ARRANGEMENTS SHOULD BE CHANGED AND IF SO, WHETHER ANY CHANGES SHOULD BE LEFT TO THE INDUSTRY TO MAKE THROUGH RAISING CHANGES TO THE MRA OR WHETHER OFGEM SHOULD SEEK TO MAKE CHANGES TO THE SUPPLY LICENCE TO IMPLEMENT THEM.

5.1 As stated in our response to question 1, we do not believe it is either necessary or appropriate to amend the industry rules in a fundamental fashion. However, at both paragraph 3 of our letter and in paragraph 2.4 above, we set out changes we believe Ofgem should implement to benefit competition in the market.

5.2 Leaving change to the industry is not satisfactory. Ofgem will have seen from the appeal process, in particular the result in the MRA Forum, that industry participants have engaged in the debate over in-contract saves from a position dictated by their own practices, rather than based on any principled position.

[2] Suppliers do not always respect customers' existing contract terms. In such circumstances, a customer who re-contracts during the ORP should not be held to any provisions in the "new supplier" contract.

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BGTL'S SUBMISSIONS TO OFGEM ON INDUCING BREACH OF CONTRACT

31 MAY 2007

1. INTRODUCTION

1.1 BGT anticipates that its competitors will submit that BGTL's practice of in contract saves during the Objection Raising Period (**"ORP"**) constitutes the tort of inducing breach of contract.

1.2 BGT recognises that Ofgem may be concerned that, if it is seen to approve in contract saves, Ofgem and/or the MRA may be seen to approve tortious conduct. BGT addresses these potential concerns in this submission.

2. EXECUTIVE SUMMARY

2.1 Whether BGT has committed a tort is a mixed question of fact and law. It must be determined on a case by case basis. Only the Courts have the jurisdiction to so determine on the basis of a particularised claim and evidence. At present there is no claim that BGT has committed a tort nor any evidence on which a Court would have the basis to so hold. It would be inappropriate for Ofgem to purport to do so in the same circumstances.

2.2 If Ofgem allows its decision on this consultation to be influenced by the suggestion that BGT may have committed a tort, in addition to being an arbitrary and unjust way of proceeding, such a conclusion will have an anti-competitive effect.

2.3 BGT has not committed any tort. Indeed, given the way in which the electricity market operates – i.e. customers continually switching suppliers in search of the best deal, often breaching their agreement with their existing supplier in the process – it is inherently unlikely that any market participant would commit the tort. This is because the tort, as will be seen below, requires knowledge that the conduct will induce a breach of contract and an intention to so induce. **When the predominant motive is to win business for your own company, that motive is not satisfied even where breach of contract is a foreseeable consequence of competing for business in this way.**

2.4 If BGT has committed a tort, then so too have its competitors. This is because it is irrelevant whether the alleged inducement occurs during or after the ORP. If in contract saves during the ORP are tortious, then so too are win-backs, as practised by suppliers in the electricity and other industries. Supplier driven competition would be effectively impossible if one supplier cannot offer a better deal to another's customer for fear of committing the tort of inducing breach of contract.

2.5 For reasons explained below, an allegation of tortious behaviour against BGT for upselling is a case of pots calling kettles black. In many cases, BGT is winning back former customers who very likely breached notice provisions when signing to a New Supplier in the first place.

3. INDUCING BREACH OF CONTRACT

3.1 The elements of this tort are:

(a) an existing contract;

(b) knowing inducement of that contract;

(c) intention to induce breach;

(d) actual damage; and

(e) an absence of justification.

3.2 The form of the tort which appears to be alleged against BGT is "direct" inducement. This occurs where A, either by himself or his agents, pressures or persuades B to breach his or her contract with C.

3.3 For present purposes, the relevant requirements are:

(a) knowledge that the conduct *will* induce a breach of contract; and

(b) intention to breach the contract either as an end in itself or as a means to an end. It is not sufficient that breach is a foreseeable consequence.

3.4 There is no liability for negligently (as opposed to intentionally) interfering with a person's contractual rights. If A intended to cause, and did in fact cause, B to breach his contract with C, only then is A's conduct actionable by C.

3.5 The House of Lords' decisions in **OBG v Allan; Douglas v Hello!; and Mainstream Properties v Young** have significantly clarified the knowledge and intention requirements of the tort. Relevant extracts from the decision are set out in the Annex to this note.

BGT did not commit the tort of inducing of breach of contract

3.6 First, BGT did not have the necessary knowledge. It knew the customer had a contract with a competitor (albeit one which may itself have been entered in breach of contract and was in any event conditional on registration). It did not, however, know the terms of that contract nor whether the customer was going to breach such terms nor, in the circumstances, could it be said that BGT ought reasonably to have known that the customer would breach such terms given that the proposed transfer was subject to an objection.

3.7 Second, BGT did not have the necessary intention to induce a breach of the contract either as a means to an end or as an end in itself. Instead, it intended to make that customer a competitive offer which it hoped the customer would accept. Breach by the customer was one foreseeable, but not inevitable, consequence of competition. However, breach was not an end desired by BGT nor was breach of the new supplier's contract a means to the end desired by BGT – re-contracting with the customer. If accepted, such offer would have resulted in the customer becoming BGT's customer. It does not follow that the contract between the customer and the New Supplier would necessarily be breached nor that BGT knew or intended that it would be breached. The notice requirements under that contract are a matter between the customer and the New Supplier and not known to BGT.

3.8 If an intention to win customers is sufficient to make out the tort, it is difficult to see how BGT or indeed any supplier could approach any customer who had a current electricity supplier (irrespective of whether that customer was a former or new customer) with a competitive offer for fear that the customer might fail to give notice in terms of the contract.

3.9 Indeed, if BGT has committed the tort, it is difficult to see how competition is possible at all. If, for example, one Supplier publishes an advertisement which makes an offer which the customer chooses to accept in breach of its contract with its existing Supplier, that

Supplier will suffer economic harm. However, no reasonable commercial person would suggest that that constituted a tort. If so, it would seriously restrict normal competitive behaviour, not just in the electricity market but in all markets.

4. CONCLUSION

4.1 This consultation is not the appropriate forum to determine whether BGTL's conduct constitutes the tort of inducing breach of contract. That question can only be answered by the Courts on a case by case basis.

4.2 The burden of proving that BGT intended to persuade its competitors' customers to breach their contracts lies on BGT's competitors. None has come close to discharging this burden and indeed none has embarked on this task before the Courts. In any event, given that *when* an alleged inducement occurs (i.e. during or after the ORP) is irrelevant to whether the tort is committed, if BGT's conduct were tortious (which it is not) then it is probable that the conduct of all suppliers who win customers from competing suppliers, is tortious whenever they do.

4.3 In short, BGT satisfies neither the requirement of knowing it is inducing a breach of contract nor (accordingly) does it intend to do so.

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ANNEX

EXCERPTS FROM OBG LTD AND OTHERS V ALLAN AND OTHERS; DOUGLAS AND OTHERS V HELLO! LTD AND OTHERS; AND MAINSTREAM PROPERTIES LTD V YOUNG AND OTHERS [2007] UKHL 21

Knowledge

1. Lord Hoffman observed at para 39:

"To be liable for inducing breach of contract, you must know that you are inducing a breach of contract. It is not enough that you know that you are procuring an act which, as a matter of law or construction of the contract, is a breach. You must actually realize it will have this effect. Nor does it matter that you ought reasonably to have done so."

2. Lord Nicholls observed, at para 191, that mere causative participation is not enough:

"A stranger to a contract may know nothing of the contract. Quite unknowingly and unintentionally he may procure a breach of the contract by offering an inconsistent deal to a contracting party which persuades the latter to default on his contractual obligations. The stranger is not liable in such a case. Nor is he liable if he acts carelessly. He owes no duty of care to the victim of the breach of contract. Negligent interference is not actionable."

Intention

3. The next question is what counts as an intention to induce a breach of contract. Lord Hoffman stated at para 42-43:

"It is necessary for this purpose to distinguish between ends, means and consequences. If someone knowingly causes a breach of contract, it does not normally matter that it is the means by which he intends to achieve some further end or even that he would rather have been able to achieve that end without causing a breach.

...

On the other hand, if the breach is neither an end in itself nor a means to an end, but merely a foreseeable consequence, then in my opinion it cannot for this purpose be said to have been intended. That, I think, is what judges and writers mean when they say that the claimant must have been "targeted" or "aimed at"."

4. Lord Nicholls observed at para 202:

"An honest belief by the defendant that the outcome sought by him will not involve a breach of contract is inconsistent with him intending to induce a breach of contract. He is not to be held responsible for the third party's breach of contract in such a case,. It matters not that his belief is mistaken in law. Not does it matter that his belief is muddle-headed and illogical..."